A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1961 August

Contents

THE Trend OF BUSINESS

Business activity was moving upward at a brisk pace in early summer, after adjustment for the usual effects of vacations and hot weather. In the second quarter total spending on goods and services was at an annual rate of 515 billion dollars—14 billion higher than in the first quarter and 9 billion above the previous record in the second quarter of 1960. Government officials had indicated in June that total spending might reach 530 billion dollars by the fourth quarter. This level could be attained even with some slowing of the recent rate of rise in activity.

In June industrial production had regained the pre-recession level of a year earlier. Total employment rose sharply and reached a record 68.7 million. Nonfarm employment passed the 62 million mark, 1.5 million more than at the start of the year after allowance for seasonal forces. Consumer buying was increasing slowly but steadily.

The rise in activity in recent months has been broadly based, with gains reported in virtually all types of manufacturing as well as in construction and service industries. Largely because of the recent fast pace of the recovery, it is likely that any further increase during the summer will be slower. A few industries, such as steel and farm equipment, have experienced declines recently. In the former case the movement is seasonal and new orders suggest an early revival. But farm equipment sales have been affected by the acreage reductions under Government programs, drought in the northern Plains and some price weakness in farm commodities.

Rising Government outlays are playing an important role in the increase in total spending in 1961. During the current calendar year total Government payments to the public are expected to rise about 10 billion above the 95 billion dollars of last year. Various new programs, particularly in the defense area, may lift this total still higher.

Employment up sharply

In the second quarter nonfarm wage and salary employment rose 900,000 or almost 2 per cent on a seasonally adjusted basis. About half of this increase was accounted for by production workers in manufacturing, concentrated in primary metals, motor vehicles and fabricated metal products. Employment also has risen substantially in contract construction and in state, local and Federal government.

Unemployment rose seasonally by 800,000 in June and remained at 6.8 per cent of the labor force as large numbers of young people sought employment. However, there was a significant decline of 200,000 in the number of adult men unemployed.

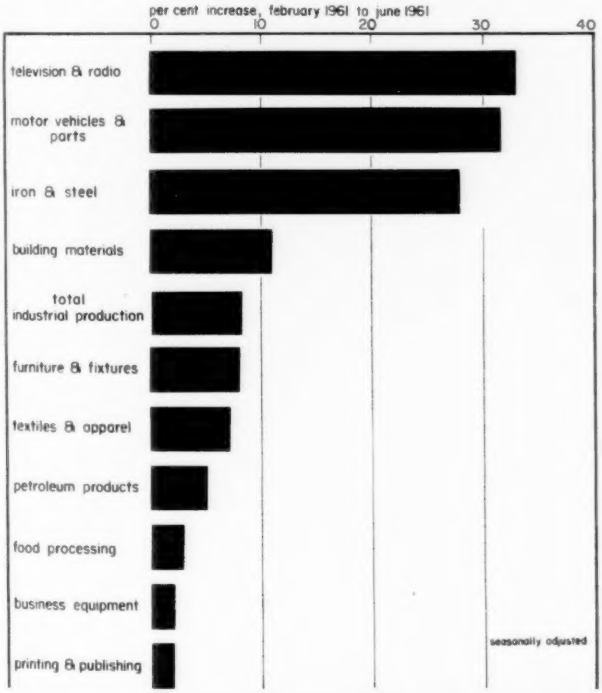
In June, 16 major labor market areas were reclassified as having an improved employment situation; ten of these were in the Midwest. Chicago, Grand Rapids, Kalamazoo, Lansing, Kenosha and Racine are no longer considered "substantial labor surplus" areas. Unemployment in these centers has

dropped below 6 per cent. Some betterment was also noted in Battle Creek, Flint, Saginaw and Detroit although unemployment in these centers continued to exceed 6 per cent. The improvement in Midwest cities stems mainly from increased production of steel, cars and trucks and machinery.

In the nation, 88 of 150 classified centers had more than 6 per cent unemployment—down from 101 in April. For the Seventh District, 11 of 23 centers were in the substantial labor surplus class in June, contrasted with 19 of 23 in April. By this standard, in two months the District has moved from a position of having relatively more unemployment than the nation to comparatively less.

Accompanying the improvement in employment, personal income rose to 417 billion dollars, annual rate, in June—about 3 per cent above the level a year earlier. This was the fourth month of rising personal income. The bulk of the increase has been in wage and salary payments.

Production increased in all major industry groups in recent months



Construction in strong rise

Total construction activity was at an annual rate of 56.5 billion dollars in June, the highest in almost two years. Most of the recent gains are traceable to highways and residential construction. Until late in the second quarter residential building had been the weakest large segment of construction. Now there is evidence of improvement in this sector. The annual rate of new private housing starts approached 1.4 million in June, 7 per cent above the year-ago level.

Rising construction during 1961 had been anticipated early in the year on the basis of the sizable volume of contract awards. The Department of Commerce now estimates that total construction during 1961 will be up 4 per cent from 1960 and housing starts will be up 3 per cent. These forecasts indicate a further rise in building activity in the second half. The first half of 1961 showed a gain of only 1 per cent in total construction outlays over the same period of 1960 and housing starts were 3 per cent lower.

On June 30 the President signed the Housing Act of 1961 which liberalizes terms of mort-

gages underwritten by the Government. Maturities on FHA-insured mortgages can now be as long as 35 (and even 40 years in special cases), instead of 30 years. Down payment requirements have been liberalized, and the maximum mortgage for a single-family home has been increased to $25,000. The bill also provides for insurance of loans for major home repair and rehabilitation of up to $10,000 in amount and with maturities as long as 20 years.

Consumer spending—will it give depth and breadth to the recovery?

Projections of consumer expenditures play a key role in nearly all business forecasts. While the initial rise or decline in activity often develops in some other sector—such as inventories, government spending or orders for new machinery and equipment—estimates as to the probable strength and duration of a recovery or recession rest heavily upon prospects for purchases by consumers. Because consumer spending accounts for two-thirds or more of total demand, even small changes can outweigh relatively large shifts in other types of expenditure.

Modest rise in retail sales

Since midyear it has been clear that the low in the 1960-61 recession was passed late in the winter, but consumers have been stepping up their demand for goods only mildly. In the face of the pickup in employment and personal income, should the slow rise in retail sales be viewed merely as a more or less characteristic lag in consumer spending or does it suggest that the current recovery might be short and weak? A look at the record in other recent periods of increasing activity may help to provide an answer.

Retail sales, measured on a seasonally adjusted basis, rose slowly between April and June, from 17.9 to 18.3 billion dollars—with automobiles accounting for much of the gain—but at midyear they were still running 1 to 2 per cent below the year-ago level. Sales by dealers in consumer durables, including autos, while rising in the second quarter, nevertheless were off nearly 9 per cent from their year-earlier pace.

In some respects the current slow pickup in buying at retail is very similar to experience in the recovery phases that followed the earlier postwar recessions. In both 1954 and 1958 it was not until several months after the lows in general activity that retail sales began to show any vigor. In the recession of 1948-49, on the other hand, sales of durables—although not the total for all goods—were rising even as the low in general activity was reached, but this undoubtedly reflected the special impact of the backlog

of demand for autos, home furnishings and appliances that continued for several years following the end of the war.

Retail sales, of course, are only a part of total consumer spending. Expenditures on services, including such a wide range of items as rent, household utilities, medical care, recreation and education, account for a high and growing proportion—about 40 per cent in 1960—of all consumer spending (see *Business Conditions,* November 1960). The rising trend of spending on services slowed only mildly during the 1960-61 recession and in the second quarter of this year had advanced to a record 138 billion dollar yearly rate.

Outlays for nondurable goods also were up slightly during the first six months, achieving an annual rate of 154 billion dollars in the April-June quarter. This was 1 billion dollars or so above the rate in the latter half of last year and about the same as in the second quarter of 1960. The combined gain for services and nondurables more than offset the dip in outlays on durable goods, producing a slight gain for total consumer spending—to a record 333 billion dollar rate in the second quarter of 1961.

Home purchases continue in slump

One feature of consumer behavior that appears to be quite different in the current business recovery than in similar earlier periods is the trend in purchases of homes. While no precise measure of total value or number of residential property transfers is available, recordings of nonfarm mortgages of less than $20,000 on both new and used houses provide a reasonably good indication. During the first four months of 1961 mortgage recordings continued at the reduced level of late last year. At comparable stages in the three earlier business recoveries, mortgage recordings were moving upward, the "cyclical" lows having been passed before. Nevertheless, the volume of new construction was rising at midyear.

The pace of home-buying activity reflects not only consumers' demand for housing but also their attitude regarding the assumption of additional debt. This is true, too, of autos and other durable goods which frequently are bought on credit.

Consumer instalment borrowing, which tends to move in close agreement with purchases of durables, rose moderately during the first half of 1961, but was running consistently lower than in the first half of last year. Month to month, the pattern of new credit extensions reflected the somewhat erratic course of purchases of hard goods.

An air of hesitancy?

The mild upturn in instalment borrowing and absence of a rise in home financing by mid-1961 indicated that households had yet to display the renewed willingness to assume additional debt obligations, while stepping up their current expenditures, which has been almost a hallmark of firm recovery in the consumer sector. Although too short a time has passed since the low of last winter to confirm any doubts that consumer buying will contribute materially to the depth and duration of the recovery, there are some factors in the current situation which could cause consumers to depart from familiar paths.

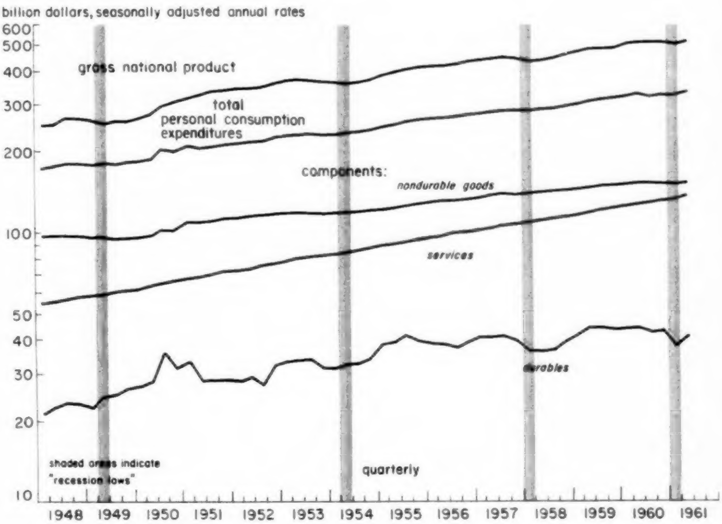
Among these is the substantial number of unemployed. Although the total of persons at work reached a record in June, the rate of unemployment remained relatively high, at 6.8 per cent of the work force. In some local areas unemployment rates have been considerably higher for extended periods. Softness in the job market tends to dampen the

buoyancy of consumers' plans and expectations and hence the direction and make-up of consumption spending. Large additions to the labor force in the years ahead and possible rapid progress in automation may tend to maintain unemployment at relatively high levels and provide additional restraint on wage rate increases and consumer optimism.

Tension in the sphere of foreign relations is another factor which may be adding to uncertainty. Genuine alarm, of course, might be expected to touch off a surge of buying by consumers, but the more moderate anxiety of the present appears to have prompted an inclination to hold back, to accumulate liquid assets and to go slow on new debt commitments.

The comparative adequacy of consumer stocks of "real" assets is believed by some observers to constitute a further deterrent to vigorous growth of consumer buying. One difficulty here, though,

Consumer spending usually has lagged in early stage of recoveries



Home buying rose early in three prior recoveries but was not leading in current expansion

is that "adequacy" to some extent depends on the level of income, current and prospective, at the time the judgment is made. The homes, autos, home furnishings, appliances and other appurtenances of the nation's households considered suitable when personal income was growing only slowly (if at all) and employment prospects were uncertain, often are considered deficient once prospects improve. Given a further pickup in consumer income and in the job picture, it is not unlikely that many households will soon decide to replace or add to their present holdings and to utilize savings and credit to finance purchases.

The growing relative importance of service outlays in consumer budgets and the evident imperviousness of this type of spending to mild fluctuations in business activity means, of course, that a reduction or slowing in the rate of climb in *total* consumer expenditure has its major impact on spending for goods. Retail sales, therefore, may not be an adequate indicator of changes in consumer spending. Uncertainty as to the outlook for this sector indeed may partly reflect buoyancy in the prospects for expenditures on travel, personal care, education, entertainment and other services and for home purchases—transactions included only in part among retail sales.

A favorable setting?

The picture also includes some factors which indicate that consumers may participate aggressively in the near future. The recent sluggishness of instalment borrowing has taken place along with a record rate of debt repayment and a very high rate of saving. The total of instalment debt owed by consumers declined somewhat in early 1961. Allowing for the typical seasonal pattern, repayments on outstanding obligations exceeded new borrowing by 375 million dollars during the first five months. As a result instalment debt totaled 42.1 billion dollars at the end of May, down 1.2 billion and somewhat more than seasonally from the record 43.3 billion mark reached at the turn of the year. The rate of repayment on existing instalment debt remains at a high level, slightly in excess of 13 per cent of total personal income after taxes, but the lessening in liability outstanding probably has improved the current buying "capacity" of consumers.

Another factor is the high level of time deposits, savings and loan shares and similar liquid assets held by consumers. (See article beginning on page 8.) Consumers typically step up the rate at which they add to these assets when prospects are uncertain and reduce the rate of accumulation as they become more optimistic. The inclination to channel income into current expenditures, moreover, often is strengthened by the presence of sizable liquid balances.

Over-all, then, the response of consumers to the current indications of rising business activity are more like than unlike their responses in similar earlier periods. While the current situation has many earmarks of its own, consumers are in a favorable position to add their very considerable weight to the side of further increases in consumption and hence production and employment.

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Shift from saving to spending?

Since March, consumer attitudes toward saving have undergone a noticeable change. The rapid rise in time deposits at commercial banks, savings and loan shares and other personal holdings of liquid assets that began in 1960 shows signs of slowing down. Redemptions of E and H savings bonds, after being below sales in the first three months of the year, have exceeded sales beginning in April. The shift to a slower rate of growth in the acquisition of liquid savings over-all, however, is far from being "across the board" at this time. There are areas in which no changes in savings behavior are detectable. In previous periods, such shifts as *have* occurred recently almost invariably have signaled an upturn in consumer spending for durables.

The mid-1960 swing to liquidity

Beginning about May 1960, as business activity began to slacken, commercial banks experienced an increase in savings and other time deposits. This continued during the early months of 1961. Passbook savings in Seventh District banks rose from 7.7 to 8.3 billion dollars, or 8 per cent, in the year ending in March 1961. Another factor of increasing significance since the beginning of the year has been the sharp rise in time deposits of corporations. Some of these resulted from the issuance of noninterest-bearing certificates to a large retail firm in payment for consumer instalment paper, and some are interest-bearing negotiable time certificates that are being actively promoted for the first time by banks in a few large cities. Corporate time deposits in Seventh District banks rose from less than 100 million dollars in March 1960 to 350 million a year later and by May were 480 million.

Sales of E and H bonds, which had begun to rise in the fall of 1959 following announcement that the rate of interest paid on them would be raised from 3¼ to 3¾ per cent, showed sustained growth during the recession. Other types of personal savings such as savings and loan shares also rose. Seventh District insured savings and loan associations reported an increase of 13 per cent in share capital in the year ending last March, several percentage points more than in the previous twelve-month period.

A turnabout in consumer attitudes toward liquid savings appears to have started in March. It has differed in some respects from similar shifts in other recent periods of economic recovery. For example, in the Seventh District the rate of gross *inflow* of funds into savings and loan shares has declined in some cities, particularly in Chicago. Also, the rate of *withdrawals* from both bank savings deposits and savings and loan shares in various Midwest areas for which such data are available rose before retail sales of consumer durables began to increase. Initial increases in withdrawals may have been occasioned by a greater-than-usual need for funds to pay income taxes in March and April. Continuation of the trend into May and June, however, suggests that more consumers again may be starting to use their financial reserves to finance purchases deferred while the economic outlook was clouded with rising lay-offs and shortening work weeks.

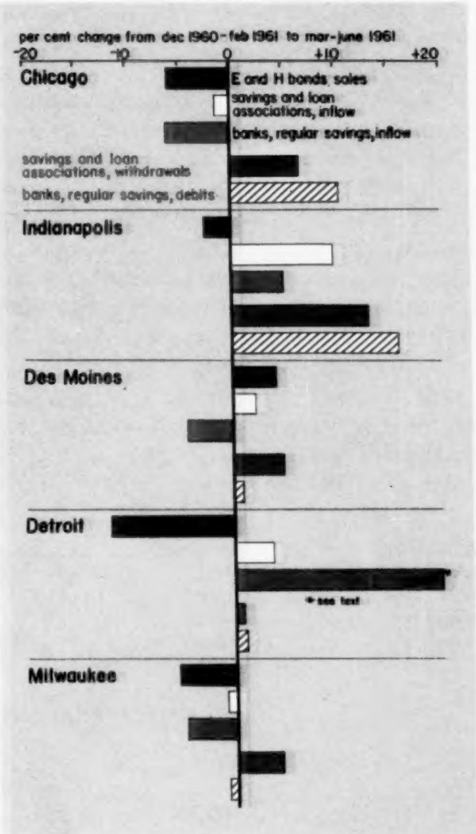
While savings data for the Seventh District support the conclusion that a trend toward rising purchases—aided by the consumers' store of liquid assets and improved capacity to assume instalment debt—may now be shaping up, this same information on a city-by-city basis points up the substantial amount of variation that exists. In areas such as the eastern Michigan cities which were harder hit by income losses stemming from widespread and prolonged unemployment, there have been relatively small increases in savings deposits and shares in savings and loan associations during the recession. Principally, this is because high withdrawals by those who supplemented reduced incomes with past savings more than offset the effect of those who were able to reduce withdrawals merely by curtailing their spending.

Inter-area variations

The Chicago area shows the most consistent response of savers to improving economic conditions. As is indicated in the accompanying chart, seasonally adjusted gross flows of funds *into* bank savings deposits, savings and loan associations and E and H bonds all have declined from the high rates in the winter of 1960-61. Moreover, withdrawals of savings deposits and savings and loan shares have risen; for the two combined, the rise from the December 1960-February 1961 average rate is close to 7 per cent. (Redemptions of E and H savings bonds on an area basis are not available.)

Information for credit unions in the Chicago area (not charted) shows similar changes. Cashings of credit union shares during all but one month of the period from July 1960 through February 1961 were below the volume a year earlier. Beginning with March, however, they have exceeded their year-ago levels.

Changes in gross flows of savings



Changes in the flow of savings in Chicago followed similar patterns during the 1957-58 recovery. Gross inflow into savings deposits declined about 5 per cent in the three months following the trough reached in April 1958. Sales of savings bonds fell, also by 5 per cent. Withdrawals at both banks and savings and loan associations rose somewhat.

Since March, gross inflow into bank savings accounts and savings and loan shares in Indianapolis has increased, but withdraw-

als have increased even more rapidly. The same is true for savings and loan shares in Des Moines. For each area, the net result is a slowing in the rate of growth of these liquid holdings.

In Detroit, activity in savings accounts stemming from changed consumer attitudes has been obscured by flows resulting from the recent decision of a number of banks in the area to convert substantial amounts of time certificates and various types of open accounts owned by individuals to regular passbook savings. These transactions have been reflected in a greatly increased flow of funds into regular savings and withdrawals (not charted) from other types of time deposits. Without this, the inflow into regular savings in March through June might well have been less than in the preceding three months. The most significant difference between the Detroit, as well as the Milwaukee, experience compared with that of the three other areas shown in the chart, is the relatively smaller increase in withdrawals from savings deposits and savings and loan shares.

Withdrawals in Detroit, contrary to the trend in the majority of other Midwest areas, remained about at pre-recession levels during the third quarter of 1960 and then increased in the final quarter and the first two months of 1961. In Milwaukee, there was some decline in withdrawals but less than in the District as a whole. In these areas, the behavior in withdrawal activity in the spring of 1961 may be evidence that many families are still deferring hard goods buying until their holdings of liquid assets are increased further and their debts are reduced.

The stock market in 1961 . . . reflects shifts in expectations as it revalues shares in American business

In May the Dow-Jones index of industrial common stocks topped the 700 mark. From the recession low in the fall of 1960 this measure of the level of stock prices had advanced about 25 per cent. At 700, the industrial average was more than four times as high as in the early postwar years and 80 per cent higher than the pre-depression peak in September 1929. By a broader measure—Standard and Poor's composite stock price index of 500 stocks—prices were more than double the 1929 peak.

The economy has changed greatly in the past 32 years. Goods and services are being produced currently at a rate five times as high as in 1929. The general price level, like the stock market, has about doubled in the intervening years with physical activity increasing about two and one-half times. Corporate profits after taxes in 1961 will be almost triple the 1929 amount.

Prior to the crash in the autumn of 1929 the level of stock prices had risen more than 50 per cent in a twelve-month period, from a point which, in turn, had been a record high. In the ensuing slide which continued irregularly to the summer of 1932, the total value of stocks traded on the exchanges de-

Stock indexes and averages

There are several widely used measures of stock prices. One of the most comprehensive is Standard and Poor's composite stock price index. It includes 500 stocks which account for about half of the total number and 90 per cent of the current market value of all common stocks listed on the New York Stock Exchange. Companies are added and deleted from time to time to keep the various groups of stocks in the index proportional with their relative importance in the market. When such changes occur the calculation of the index is adjusted so that the series is linked and continuous.

In computing the Standard and Poor's index, prices of each issue are "weighted" by the number of shares outstanding, which gives the current market value for that issue. This procedure largely eliminates the effects of stock splits and stock dividends on prices. Adjustments are made also to offset the effect of sales of new stock by firms included in the index and to take into account mergers, acquisitions and liquidations. The resulting values are expressed as an index, using the 1941-43 average values as a base set equal to 10. An index of, say, 60, would indicate a sixfold increase in the unit value of the representative list of stocks in the index, after adjustment for the changes noted above.

The total *value* of stocks has increased more over relatively long periods than any of the stock *price* indexes in common use. Between the end of 1948 and the end of 1960 the total value of all stocks listed on the New York Stock Exchange, for example, increased 358 per cent while the Standard and Poor's composite index rose 280 per cent, the Dow-Jones industrial average, 251 per cent and Moody's 125 industrials, 265 per cent. This faster growth in the total market value of stocks results from several factors. As noted above, the index does not reflect increases in value of stocks which result from sales of new stock by companies included in the index, and appropriately so, since it is designed to measure price changes, not total value. However, the sale of additional shares, by both the firms included in the index and other firms, increases the total value of shares as does the organization of new companies, many of which have experienced rapid growth.

Stock price indexes such as the Standard and Poor's composite are subject to certain limitations in measuring price changes of common stocks. The lists exclude many important firms, particularly in new industries. The shares of these firms may show quite different performances than those included in any particular index or average even though efforts are made to keep the index "representative" of the general market.

Changes in stock prices, as shown by the widely used indexes, provide a useful means of comparing the performance of individual portfolios with that of larger groups of stocks or even with "the market." The indexes are not designed, however, to measure the growth of the economy, the rise in the total value of business enterprises or the increase in the equity in these firms.

clined by more than 80 per cent. Postmortems on the 1929 crash concluded, almost universally, that stock trading in 1929 had reflected "wild speculation." The rise in common stock prices in that year and the subsequent collapse were commonly described as "America's South Sea Bubble"—a reference to a speculative binge in the stock of the South Sea Company in London during the early 18th century.

In the 1930's Congress enacted legislation to deal with some of the abuses which had accompanied the stock speculation of the great bull market. Responsibility for determining margin requirements, to limit the use of credit in stock purchases, was placed with

the Federal Reserve System. The Securities and Exchange Commission was created and given a broad range of authority for regulating the issuance and trading of securities. With these safeguards and the disillusionment resulting from the collapse, it was believed that the public would show greater discrimination in the purchase of stocks.

The recent record highs in most measures of stock prices appear to have been reached without the major earmarks of speculative activity which were evident in the late 1920's. The volume of trading, for example, has been relatively much lower than in the earlier period. After increasing substantially in early 1961, trading on all the stock exchanges (expressed as an annual rate) was about 20 per cent of the number of shares of listed stocks compared with over 100 per cent in 1928 and 1929.

The amount of credit employed in stock market trading, though growing recently, has been moderate when contrasted with the 1920's. There has been relatively little sign of manipulation and rigging of stock prices by insiders—one of the unsavory aspects of the earlier era. Nevertheless, the postwar period has witnessed four broad upswings of stock prices which have carried the market to successively higher levels. Measures which relate stock prices to earnings, dividends, the general price level or the volume of savings indicate that the market has recently been quite high if judged in terms of past relationships. Changes in tax laws and expectations as to economic growth and inflation are, of course, powerful factors affecting stock prices.

The 1955 study

The Senate Committee on Banking and Currency in March 1955 undertook a study of the stock market following a rapid advance in prices which had carried the market averages up about 40 per cent during the preceding twelve months.

Witnesses drawn from business, financial and academic circles were asked their views as to the possibility that the market rise had advanced stock prices to dangerously high levels. Typically, the response was that the upswing was justified by the state of the economy and the prospects for the maintenance and growth of corporate profits. It was suggested that the market had been unreasonably low in the early postwar period rather than too high in 1955. Confidence in the nation's future prosperity and an expectation of continuing inflation were given as the major reasons for the market's advance.

A number of statistical comparisons were offered to show that stock prices were low relative to the 1929 peak, inferring that there was no reason to fear a possible collapse merely because prices had risen rapidly. Nevertheless, the majority report of the committee found that recent market developments had been characterized by "signs of increased speculative activity," that interest was centering on capital gains rather than "earnings and other sound investment criteria" and that in certain extreme cases speculative activity constituted "a flight from reality."

When the committee issued its report in May 1955, the Standard and Poor's composite stock price index was 37.60 (1941-43=10). In May 1961 this index reached 67.39—a rise of almost 80 per cent in the six-year interval; a comprehensive index of prices of commodities and services had risen about 15 per cent over the same period. Corporate profits after taxes totaled 23 billion dollars in 1955. It is unlikely that this figure will be exceeded by any wide margin in 1961.

Postwar rise in stock prices
not matched by corporate profit growth

It is interesting to reconsider the data offered in early 1955 to support the view that the market was not too high. For example, the price-earnings ratio (the multiple of annual earnings at which stocks sell) for Moody's industrial stock average was 14 at the end of 1954 compared with 17 in August of 1929. Recently this ratio has been about 19. Moody's average common stock yields (dividends as a per cent of market price) were 4.09 per cent at the end of 1954 compared with 3.19 per cent in 1929. In May 1961 this figure was 3.11 per cent.

It was suggested in early 1955 that common stocks, even at their advanced prices, were a good buy relative to bonds. Yields on stocks were about one-third *higher* than on bonds, while in 1929 the situation was reversed. Since 1955, stock yields have declined while those on bonds have risen, with the result that recent yields on stocks, as measured by Moody's, have been about one-third *below* the yields on high-grade bonds—about the same as in 1929.

Through most of the 20th century, common stocks have yielded more than bonds issued by firms of comparable standing. The reason usually offered is that the payment of interest is contractual whereas dividends on stock are uncertain.

When stocks are yielding much less than bonds in periods of prosperity, there is an indication that many stock purchasers are more interested in capital appreciation than in current dividend income. This may be because they expect a substantial increase in dividends in the future or because investors are willing to forego current returns in order to purchase equities which they believe will go up in value. Many buyers believe that inflation of prices of goods and services will cause stock prices to increase.

Stock prices have risen in recent years despite the fact that corporate profits after taxes have not moved up substantially during the postwar period. Profits after taxes in 1959, the peak year, were only 16 per cent higher than in 1948, while the nation's total output of goods and services was 86 per cent higher. Common stock prices were four times as high in 1959 as in the earlier year.

A business indicator?

Stock price indexes were fairly stable at a low level in 1947 and 1948. The postwar

uptrend in stock prices began in mid-1949 and has continued to the present although interrupted by declines in 1953, 1957 and 1960—years which saw the beginnings of business recessions. In each recession the market resumed its upward trend several months before business activity touched bottom, thereby enhancing the reputation of the market as a "leading indicator" that tends to presage general economic developments.

In the early postwar years, yields on common stocks were high, averaging 6 and 7 per cent in 1948 and 1949. Stocks of many well-known companies could be purchased for ten times current earnings, a traditional rule of thumb indicating "good values." However, many investors feared that postwar prosperity would be short-lived. They preferred to buy goods or hold liquid assets. The recessions which the nation has experienced have been unsettling to the stock market, but as it became apparent in each case that the decline in business activity would not be severe or long continued and that profits were holding up surprisingly well in the face of the modest declines in sales, confidence in the economy and therefore in stocks was bolstered.

Acceptance of the idea that the economy is less vulnerable to declines than in the past has broadened ownership interest in common stocks both on the part of individuals and institutions. The effect of this buying pressure upon prices has been magnified because of the relatively small volume of new stock issues.

According to a New York Stock Exchange survey, more than 12 million persons owned stock in 1959 compared with 7 million in 1952. Doubtless the number has increased further in the past two years.

Financial institutions have been investing more heavily in common stock in the past several years. By far the largest increase in institutional holdings has occurred in noninsured corporate pension funds. The stock held by these funds increased from 1.4 billion dollars in 1949 to 12.3 billion at the end of 1960 and undoubtedly will rise further as the funds continue to grow.

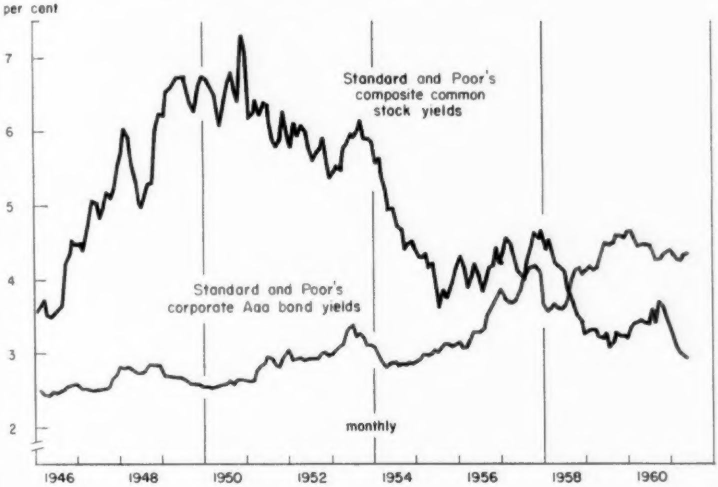
In the past six years new issues of common stocks totaled 12 billion dollars. Funds raised by corporations from the sale of bonds and increases in bank loans and mortgages totaled 58 billion dollars during this period. The market value of all common stocks listed on the New York Stock Exchange, which accounts for about 80 per cent of the value of the stock of all United States corporations, was recently on the order of 350 billion dollars compared with 200 billion six years ago. Obviously the great bulk of the increase in the value of common stock outstanding has come from higher prices for existing issues rather than from an increase in supply.

Credit and the stock market

During the 1929 bull market, purchasers of common stock used a large volume of credit to finance their holdings. Margin buying was employed extensively with brokers commonly supplying credit equal to 80 per cent of the purchase price of the stocks acquired by their customers.

Since 1933 the Board of Governors of the Federal Reserve System has had the authority to regulate the amount of credit that brokers and commercial banks can extend on purchases of listed common stocks. "Margin requirements" were as high as 100 per cent in 1946—no additional credit could be extended by brokers or banks for purchasing stock. Currently, the requirement is 70 per cent. Loans to stock purchasers from brokers (customers' debit balances) and banks were

Corporate bond yields have exceeded stock yields since 1958, reversing relationship of earlier postwar years



has been particularly striking in periods such as 1949-50, late 1954 and early 1961 when prices were increasing rapidly. Changes in margin requirements appear to have moderated these swings substantially, and when a requirement as high as 90 or 100 per cent was in effect for some period of time customer credit outstanding declined materially.

The data on credit used to purchase common stocks is not comprehensive. There are many ways in which credit granted for other purposes can, in effect, help to support the demand for stocks. For example, the investor who repays a mortgage more slowly than he would if he were not in the market really is using credit to carry securities. Stock purchasers may borrow on other collateral such as life insurance policies. Moreover, unlisted securities are not covered by the regulation and the margin requirement does not apply to all lenders. Despite these and other gaps in the figures, it appears that credit has been a significant factor in financing the 1960-61 stock market rise but of much less relative importance than in 1929.

5.4 billion dollars in May 1961. Unfortunately, comparable information is not available for 1929. However, at the end of 1931 these loans were over four times greater relative to the total value of stocks than now.

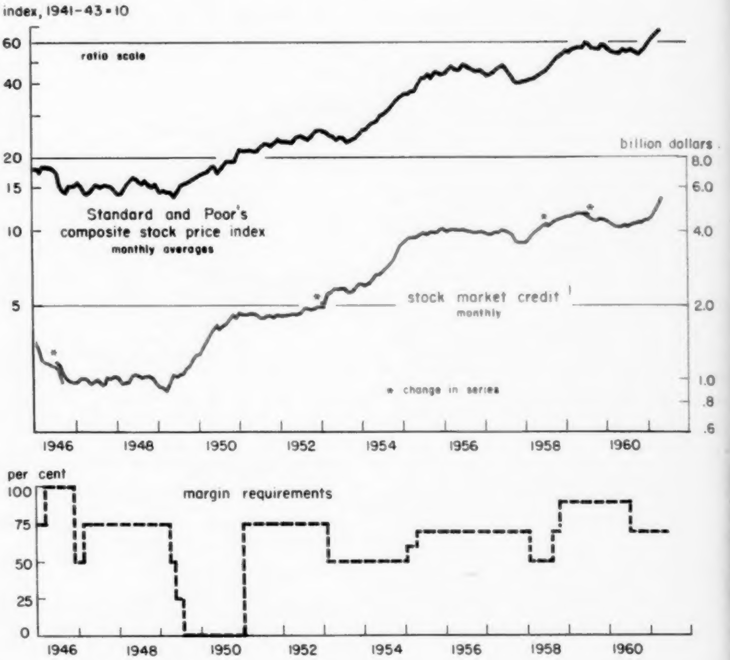
Another measure of stock market credit is the borrowings of members of the New York Stock Exchange to finance their own and customers' transactions. In May these loans were 3.1 billion dollars compared with 8.5 billion in September 1929. Brokers' loans recently were less than 1 per cent of the value of stocks listed on the exchange in contrast with 10 per cent in 1929.

Although customer borrowings for purchasing stocks have not been as high relative to stock values as in the Twenties and early Thirties, credit outstanding during the postwar period has tended to rise and decline with changes in stock prices and the volume of trading. The similarity of the movements

The stock exchange as a market

Free markets form the very essence of the private enterprise system. Among the most important of the formal markets are the stock exchanges which provide a means of deter-

Stock market credit
has fluctuated with stock prices



1Loans from brokers and banks for purchasing and carrying securities.

mining the value of ownership rights of business firms and a mechanism for readily transferring such rights.

Everyone may have an opinion as to whether the market is "too high" or "too low." The fact remains, however, that posted prices are the collective judgment of many buyers and sellers operating freely and with access to a great deal of information about the firms whose stocks are traded on the exchanges.

While common stocks have value because of the real assets they represent and the earning power of the respective firms, stock prices rest heavily upon expectations of business conditions, prospective profits, possible changes in the tax structure, Government actions and international developments. These and other imponderables affect the individual's assessment of the value of stocks, and stock prices reflect the composite of such judgments.

As pointed out earlier, a traditional "rule of thumb" for evaluation of stock prices was ten times current earnings or an average of earnings for several prior years. Today most common stocks sell for 18 to 20 times reported current earnings and shares of some firms with established or potential records of vigorous growth for 40, 50 and 60 times earnings. Obviously, the future will have to develop very favorably for these firms if recent prices for their shares are to prove reasonable in retrospect.

With the benefit of hindsight, it is evident that stock prices a decade or more ago were low. This was indicated by comparisons with such measures as earnings, yields and book value; today, by the same yardsticks, the market is high. However, as noted above, prices are affected by many factors and at least some purchasers believe the conventional yardsticks are now obsolete.